DF/22/102
Corporate Infrastructure & Regulatory Services Scrutiny Committee
24 November 2022

Treasury Management – Mid Year Stewardship Report 2022/23

Report of the Director of Finance and Public Value

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: That the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the Treasury Management Mid Year Stewardship Report.

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1. Introduction

1.1 The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2021 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2022. The Treasury Management and Investment Strategy for 2022/23 was agreed by Council in February 2022 and forms part of the published budget book.

1.2 The purpose of this report is to inform members of any key matters arising from the Council's Treasury and Debt Management activities during the first seven months of the 2022/23 financial year. It is intended to enable members to ensure that agreed policy is being implemented. This report, together with any comments offered by this committee, will be considered by Cabinet on 14th December.

2. Borrowing Strategy 2022/23 to 2024/25

2.1 The overall aims of the Council's borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

2.2 The Medium-Term Financial Strategy (MTFS) and Treasury Management Strategy set by the Council in February continued to assume that, over the three year period, no new long-term borrowing would be required, but noted that:
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- The margin between the actual external debt and the minimum requirement for external debt to fund the Council's capital priorities was narrow and would need to be kept under review.
- The growing deficit on the High Needs Block (HNB) in relation to Special Educational Needs (SEND) was likely to put significant strain on the Council's cash resources which would need to be resolved at some point.
- If key priorities cannot be delivered due to a reduced availability of external funding, the Authority's cash resources, or capital receipts, then external borrowing may be required. This would need to be balanced against the ability to support additional capital financing costs from within the revenue budget.

2.3 Subsequently, in April, the Cabinet agreed to support proposals for the creation of the Plymouth and South Devon Freeport. The Business Case includes the requirement for the Council to externally borrow up to £15 million for the capital works needed. This borrowing will be ringfenced to the Freeport, and all the associated capital financing costs will be funded by the excess business rate income derived from the scheme. The borrowing will not be required until 2023/24 and has yet to be taken out.

2.4 The Council continues to await the outcome of the Safety Valve Intervention programme with the Department for Education in relation to the deficit position on Special Educational Needs. At the end of 2021/22 the Dedicated Schools Grant High Needs Block reported a cumulative deficit of £86.5 million which was carried forward as a deficit reserve as per government guidance. When combined with the current year forecast the deficit is expected to be £123.8 million by the end of 2022/23. The conclusion of those discussions may require the Council to review its cash resources and whether further external borrowing is required to meet its capital priorities.

2.5 Active treasury management and the maintenance of levels of liquidity have ensured that no short-term borrowing has been required for the financial year to date. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

2.6 At 31st October 2022 the level of long term debt remains unchanged at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.22 £'m	Interest Rate %	Actual 31.10.22]	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

2.8 Every year the Council budgets for a Minimum Revenue Provision to set aside cash to then repay this external debt. At the same time, we are then borrowing that cash back, by way of internal borrowing from the Council's cash balances to finance the capital programme. The ability to internally borrow from the Council's cash has enabled the Council to fund its capital programme in recent years without taking out further external debt and incurring additional interest costs and other capital financing costs.

2.9 In recent years, we have reported that it would not be possible to repay any of the Council's existing external debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The PWLB sets premature repayment rates and, where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment.

2.10 However, the increase in interest rates over the last 9 months changed the scenery to some extent. Added to this Central Government Turmoil and the "mini-budget" announced in September has resulted in significant volatility in Government borrowing costs which have fed through to PWLB rates. During early October it would have been possible to repay up to 8 of the Council's loans without paying a premium, but as markets stabilised following Rishi Sunak's appointment as prime minister, PWLB rates fell from their inflated levels back to a level at which premiums would again be incurred on the repayment of any of the Council's external debt.

2.12 Officers considered whether the opportunity should be taken to repay debt, but it came at a time of significant uncertainty, when there is significant pressure on the Council's reserves and cash resources. As set out above, there may be a need for additional external borrowing, and it would not make sense for the Council to repay existing debt and then have to take out new external borrowing at higher rates than the loans that have been repaid. We will continue to monitor the position.

2.12 The earliest date on which any of the Council's external debt matures is 31 March 2027, when the Council is due to repay a PWLB loan of £33.8 million, with a further £5.8 million to be repaid later in 2027. There will need to be careful management of future capital requirements if the Council wishes to reduce external debt by repaying these loans in four years time, particularly given the current uncertainty. Otherwise, it will be necessary to take out new external borrowing to re-finance the debt.

3. Investment Strategy 2022/23

3.1 The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result, only a small number of selected UK banks and building societies, money market funds and overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. In addition, the CCLA (Churches, Charities and Local Authorities) Property Fund is being used. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list.

3.3 The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

3.5 The following table shows the County Council's fixed and variable rate investments as at the start of the financial year and as at 31st October 2022:

Schedule of Investments

	Maturing in:	Actual 31.03.22 £'m	Interest Rate %	Actual 31.10.22 £'m	Interest Rate %
Bank, Building Society & MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	127.50	0.48	171.00	2.00
	365 days & >	31.00	0.86	10.00	0.57
Variable Rate					
Call Accounts		49.01	0.58	2.32	2.05
Notice Accounts		40.00	0.32	10.00	2.34
Money Market Funds (MMF's)		16.86	0.55	58.15	2.24
Property Fund		10.00	3.72	10.00	3.66
All Investments		**274.36**	**0.64**	**261.47**	**2.08**

3.6 When the budget and treasury management strategy for 2022/23 were prepared, the Bank of England's base rate stood at 0.25%. The target rate for interest on deposits with banks, building societies and money market funds was set prudently at 0.35%. Subsequent global events and the impact on inflation has resulted in the base rate being raised several times and it now stands at 3%. As a result, the rates that can be achieved on the Council's investments have improved substantially.

3.7 Higher rates can be achieved for loans made for longer periods than for immediately available cash. However, as the Council had made a number of one year and 2-3 year investments prior to the recent rise in rates, the average rate on term deposits is currently lower than the rates available on money market and call accounts. As current investments mature the average rate on term deposits should increase to above the rates being achieved on short term cash.

3.8 The total level of cash remains high. Generally, cash increases during the early part of the year as grants are received in advance of spend, with a gradual reduction during the Autumn and Winter. It is anticipated that the cash balance at the 31st March 2023 will be around half the balance at the beginning of the financial year, but that will depend on the level of slippage on the capital programme and the level of carry-forwards at year end.

3.9 The forecast reduction in cash balances can be explained by:
- Internal borrowing to support the capital programme.
- Spending of capital grants received in previous financial years.
- Draw on revenue reserves to fund spending in 2022/23
- The increasing deficit position on Special Educational; Needs.

3.10 Revenue lending up to 31st October, including the use of term deposits, call accounts, money market funds and the CCLA property fund, has earned interest of £1.8 million against a full year budget of £900,000. It is forecast that the investment income for the full financial year will exceed budget by around £2 million.

3.11 This position results from the significant increases in interest rates since the budget for investment income was set in February.

4. Minimum Revenue Provision

4.1 Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

4.2 The current policy, following a review in 2018/19 is to charge MRP in equal instalments over the life of the asset benefiting from the capital spend, based on the annuity method. The budgeted MRP for 2022/23 was £12.733 million. It is now forecast that the actual MRP will be below budget, at £11.982 million, an underspend of £751,000.

5. Prudential Indicators

5.1 Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

5.2 The purpose of the indicators is to demonstrate that:
- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

5.3. Three Prudential Indicators control the overall level of borrowing. They are:
- The Authorised Limit - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will

not require revision until the estimate for 2023/24 is revised as part of the 2023/24 budget process.

- The Operational Boundary – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- The Underlying Borrowing Requirement to Gross Debt - the Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

5.4 During the Budget process, the following Borrowing Limits were set for 2022/23:

- Maximum borrowing during the period (Authorised Limit) - £811.193 million.
- Expected maximum borrowing during the year (Operational Boundary) - £786.193 million.
- Maximum amount of fixed interest exposure (as a percentage of total) - 100%
- Maximum amount of variable interest exposure (as a percentage of total) - 30%

5.5 Members are asked to note that for 2022/23 to date, the Council has remained within its set Borrowing Limits and has complied with the interest rate exposure limits.

5.6 The Council also sets a liability benchmark to establish the minimum level of external borrowing required to fund the capital financing requirement, taking into account the level of reserves and balances. The 2022/23 estimate showed a minimum prudent level of external borrowing of £483.28 million, compared with the actual external debt of £507.85 million. Based on the current position, the minimum prudent requirement for external borrowing remains below the current level of external debt, but the gap is expected to reduce in the medium term.

6. Prospects for 2023/24

6.1 As this report is being prepared, the Government is due to set out its Autumn Statement to Parliament on 17th November. A further oral update can be provided at the Committee, but it is anticipated that it will include a further squeeze on public sector spending from April 2023. Even before this announcement, Devon County Council is projecting that savings of £75 million will be needed next financial year unless the Government takes steps to protect public services.

6.2 Discussions continue with the Department for Education around the deficit on Special Educational Needs (SEND), but as yet no resolution has been reached. The current level of uncertainty makes it difficult to predict whether the Council will have the cash resources available to fund its capital priorities without external borrowing. If new external borrowing is required, then the increase in interest rates means that it will be significantly more expensive than it would have been 12-18 months ago. The additional capital financing costs would add to the current revenue budget savings requirement.

6.3 Interest rate volatility is likely to continue for some time, with further increases in the Bank of England base rate expected over the coming months. This may present further opportunities to repay existing debt early without premium, which could then result in savings to the revenue budget. Officers will continue to monitor this position but given the current uncertainty it is difficult to forecast whether the Council will have sufficient cash resources to make the repayments without the risk of then needing to re-borrow at higher rates.

6.4 The good news is that the rise in interest rates will increase the level of investment income that the Council can achieve. Although cash balances are likely to be lower during 2023/24, the higher level of interest rates should enable the Council to set a target rate of 3-4% for lending to banks, building societies and other local authorities, compared to the target of 0.35% for 2022/23. This should make a positive contribution to the Council's overall savings requirement.

6.5 Further modelling of the forecast position will be undertaken by officers before the Treasury Management Strategy for 2023/24 is presented for consideration in January.

7. Summary

7.1. No long-term borrowing has been undertaken to date in 2022/23, but the Council has committed to taking out new external borrowing ringfenced to the Plymouth and South Devon Freeport.

7.2 No short-term borrowing has been undertaken to date in 2022/23.

7.3 The investment income achieved as at the end of October stands at around £1.8 million compared to the budget target for the year of £900,000.

7.4 The impact of current budget pressures on the Council's cash resources is still uncertain. The resolution of the issues around the Special Educational Needs deficit is likely to be key to determining how the Council manages its external debt over the next year and beyond.

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Electoral Divisions: All

Local Government Act 1972:
List of Background Papers: Nil
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